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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 609

THE DAYTON POWER & LIGHT COMPANY,
Appellant,

v.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

REPLY BRIEF OF APPELLANT

Preliminary Observations

The answer to the question presented by this appeal are vital to appellant, and to a large number of residents of Ohio who are dependent upon it for their gas supply. The import and effect of the rulings made by appellee and the court below in this case are so revolutionary and far-reaching, and the appellee's brief recently filed herein contains so many assertions and assumptions not predicated on the facts and conclusions not justified by the record, that counsel for appellant feel impelled to make brief response. In limiting this reply to brief comment on a few of the many unwarranted statements and unsound arguments appearing in the brief filed on behalf of the appellee, we do not, of course, mean to approve as correct or accept as justified many other observations and contentions contained therein.

Statement of Case

(Appellant's Brief, pages 2-6; Appellee's Brief, pages 1-9)

Counsel open their brief with the remark that the appellant's statement of the case "contains certain allegations with which appellee cannot agree" which makes it necessary for them to "restate the case." Reference is made to the so-called Carpenter Act on pages 2, 3, and 148-151, which legislation they concede has nothing to do with this case, but we do not note any record facts stated at pages 1 to 9 inclusive of their brief which are not included in the brief for appellant. There is, however, incorporated in appellee's statement of the case some *argument* upon which we will comment briefly.

On pages 4-5 of their brief counsel for appellee say:

> "In its brief, appellant (p. 4) refers to its valuation of $1,250,221.00 as having been established by the 'uncontradicted evidence' and labels the amounts claimed by it and disallowed by appellee either in part or in whole, as 'appellant's proof.' If the purely speculative and conjectural testimony of witnesses on behalf of appellant, which, in fact, was nothing more than the guesses of such witnesses as to the amounts which in their opinion should be allowed for such items as organization or preconstruction cost, cost of financing, cost of cutting and restoring paving, going concern value, general overheads or undistributed construction expenditures and working capital, constitutes 'uncontradicted evidence' and 'proof' even though such speculations and conjectures violate well-established principles of law, then perhaps appellant's statements are correct, otherwise they are not."

It will be noted that all through its brief appellee characterizes the evidence in this case as "speculative," "conjectural" and "theoretical." See pages 11, 12, 14, 15, 24,

28, 29, 30, 38, 51 and other pages in the brief. Counsel apparently believe that sheer repetition of these adjectives will tend to destroy the testimony of competent, able and trustworthy witnesses whose character and reputations are such that they were not assailed by representatives of the towns, the appellee, or the court below.

On page 9 counsel say: "In its statement, appellant alleges (Appellant's Brief, p. 6) that appellee based its rate order upon conditions as they appeared to it to be on November 3, 1932, instead of as they were on July 17, 1929, the day certain," and observe they cannot agree with this statement and that appellee failed to cite any portion of the record to sustain it. On page 121 of our main brief we called attention to the statement in the opinion of appellee (R. 167) that: "The test of 'equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings' presents a new question on account of *the present depression.*" The observations made by appellee in its opinion and its finding on rate of return show conclusively that the business depression existing in November, 1932 materially influenced its action.

In their attempted defense of appellee's action in failing to allow for or take into consideration in fixing appellant's operating expenses the additional excise *tax* imposed prior to the handing down of its order in this case, counsel say (p. 16): "The action of appellee in computing the excise tax on the basis of the tax as it existed as of July 17, 1929 (the date certain) and not on the basis of a subsequent enactment of the Legislature (April 5, 1932), is, of course, sound. * * * It would be absurd to give effect in a 1929 rate study to a 1932 enactment of the Legislature."

We may observe in passing that appellee ought to be consistent and not resort to a time beyond the date certain for

the purpose of reducing the rate of return allowed appellant while ignoring positive proof regarding an increase in its operating expenses due to the imposition of additional taxes by the State. If there is anything appellee might properly take judicial notice of it is the *certainty* that *taxes* must be paid.

Organization or Preconstruction Costs

(Appellant's Brief, pages 13, 24, 25; Appellee's Brief, pages 11-12, 26-29)

None of the cases cited on page 12 of appellee's brief deal specially with organization costs, and the case of *Ohio Utilities Co.* v. *Commission*, 267 U. S. 359, 362, which does consider this precise subject matter and arose in Ohio, is not cited.

On page 25 of their brief counsel say: "If we are to reconstruct the plant of the appellant in these territories as of 1929 or 1930, it is perfectly proper to consider the remainder of the appellant company as in existence. It is equally proper to consider the public of these communities anxious and desirous of receiving the service which they now enjoy." The reaching of a satisfactory conclusion is not difficult if one assumes the desired facts and necessary premises. It is clear that the various gas plants used in serving the towns in this case may not be treated like some extension of a single plant in order to serve additional consumers in the same community.

On page 27 counsel state: "The only other decision of this Court cited by appellant to sustain its position as to this item is the case of *The Ohio Utilities Company* v. *Public Utilities Commission*, 267 U. S. 359. That case is clearly distinguishable from the instant case, for the reason that in the Ohio Utilities Company case there was evidence in the record testified to by the commission's own engineers

that an allowance for organization costs should be made." Apparently counsel would have testimony given by appellee's engineers treated on a different basis to that of other witnesses. Obviously, the "reason" given does not make the Ohio Utilities case "clearly distinguishable" from this case. In that case this Court did not hold that an allowance should be made for organization costs merely because the testimony on the matter was given by the commission's engineers, but by reason of the fact that the record contained such evidence.

Cost of Financing

(Appellant's Brief, pages 13-14, 26-34; Appellee's Brief, pages 12 and 29-24)

The conclusion reached regarding this subject on page 12 of appellee's brief is predicated on the assumption of "the absence of any evidence that any such cost has been incurred in the past or actually would be incurred in the future." No such assumption is justified in this case because the evidence clearly establishes that such costs would be incurred in the reconstruction of appellant's property.

The argument of counsel for appellee under this heading is a good illustration of begging the question, and it utterly ignores the record evidence. They say: "None of these witnesses gave any consideration to the excellent financial condition of the appellant company as a whole but assumed that they were starting out with a new company having no affiliations and no banking connections. The appellee in reaching its decision to disallow the amount claimed for cost of financing determined to consider some of the actualities rather than indulge wholly in theory." No reference is made to any evidence tending to justify this statement, and there is nothing in the record to support it.

No member of the commission, counsel, witness or other person present at the hearing offered to raise the money needed to reproduce this property without cost or even questioned the fact that the persons or company attempting to secure such necessary capital would incur substantial expense. If actualities had been given any serious consideration by appellee it would have accepted the sworn testimony of responsible men who have had the experience of raising money for the construction of similar public utilities. Should the members of the commission or their counsel attempt to raise funds even to build a home they will find that banks and other lenders of money are not begging them to accept a loan of the necessary capital. The same attitude is met with in a more pronounced degree when it comes to raising large aggregations of capital for the purpose of constructing a utility to render service to the entire community.

Counsel state on page 30 that "each witness admitted that his calculations were purely on a basis of his estimate of cost of financing," and apply their stereotyped phrase "entirely speculative and conjectural." This item, like all other questions of value, expense, etc., is properly based upon the estimate or opinion of witnesses familiar with the subject matter. As observed by this Court in *Ohio Utilities Co.* v. *Commission*, 267 U. S. 359, at page 362: "Reproduction value, however, is not a matter of outlay but of estimate . . ."

Cost of Cutting and Restoring Paving Over Mains and Service Lines

(Appellant's Brief, pages 14 and 34-38; Appellee's Brief, pages 13 and 34-37)

On page 13 counsel state that the propriety of excluding this item "is so clearly established that it is not now open to dispute," and cite the Des Moines case (238 U. S. 153),

Columbus Gas & Fuel Company v. *City of Columbus*, [illegible] F. (2d) 630, 633, and Whitten-Wilcox: Valuation of Public Service Corporations, at page 778. On page 777 of the text book cited the author says: "It is truly said that if the property had to be reproduced at the present time the cutting and replacing of the pavement in many instances would be a necessary part of the process." The Ohio statute requires that reproduction cost be used in making a valuation of a utility's property other than land, and makes that the measure of value.

At page 37 of appellee's brief it is said: "It should be remembered that there is no dispute over the dollar amounts as claimed by the appellant * * * covering this item but simply over the principle involved." Counsel contend that the ruling of this Court in *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153, is decisive of the proposition. As pointed out in our main brief, the statute in effect in Iowa at the time the Des Moines case arose was different from that in force in Ohio. We do not regard the failure of this Court to reverse the master's finding in the Des Moines case as intended to lay down a universal principle of law, much less to adjudicate appellant's rights under the Ohio statute.

Going Concern Value

(Appellant's Brief, pages 14 and 38-49; Appellee's Brief, pages 13-14, 38-46)

At page 13 and again at page 38 counsel assert that where current prices as of a date certain are used in fixing the reproduction cost of property plus "[illegible] general overheads," and working capital is included, "going concern value has been given all the consideration it deserves and no *separate* allowance therefor is necessary." Here again the extravagant use of adjectives is in evidence, and a broad generalization is made without regard to the facts in this

case. Certainly, no one will contend that the allowance for general overheads made to appellant was "liberal" or generous; in fact, appellee's allowance for general overheads was substantially less than the lowest evidence and this is one of the errors assigned and relied upon in this case.

On page 43 of their brief counsel state: "The valuation formula prescribed by the Legislature of the State of Ohio does not permit an inclusion of a separate allowance for going concern value in the determination of fair value for rate making purposes." They cite Ohio G. C. 499-8, 499-9, 614-46, and the decision of the lower court in the Columbus case, 127 O. S. 109. These statutes not only permit but require an appraisal of a utility's going concern value and its allowance in the rate base; and the decision cited does not support appellee's contention.

On page 44 counsel say: "The law is well settled, both under the decisions of the Supreme Court of Ohio and of the Supreme Court of the United States, that where property of a utility is valued, not as junk or property lacking utility, but as a going plant in successful operation, the element of going value has been given all the consideration which it deserves, and no additional separate allowance for going concern value is permissible. * * * Indeed it is a matter of record that every valuation made by the appellee since 1917 which included a separate allowance for going concern value has been appealed to the Ohio Supreme Court and that the latter tribunal has without exception struck out every such allowance; and it is also a matter of record that no valuation made by appellee which omitted such an allowance has ever been declared invalid on appeal to the Ohio Supreme Court because of the absence of such an allowance."

We do not understand the decisions of either the appellee or the lower court to hold that an allowance for going

concern value may not be made because of statutory inhibition. As a matter of fact, the appellee made a separate allowance for going concern value as recently as 1931 in the Ohio Bell Telephone case, P. U. R. 1931 B, 46, 56-60; and the lower court has held it must be allowed (*Lima Telephone & Telegraph Co.* v. *Public Utilities Commission*, 98 O. S. 110, 124). If counsel's statement be correct it is obvious that the statute as thus construed would be unconstitutional, since a utility's going concern value is property which cannot be taken for a public use without compensation.

On page 45 counsel state: "The basic fallacy in the appellant's position is that it attempted to add a separate allowance for going concern value, not to evidence of fair value of property considered as junk, disconnected units or without business attached, without earnings or prospects of earnings, but to a fair value for a plant in full operation, with customers attached and earning money. It must be manifest to the most naive that if the plant of the appellant or any plant were valued as junk, or as property unassembled, or as property without customers attached, without established business, and without earnings, such a value would inevitably be only a fraction of the reproduction cost new less accrued depreciation as estimated in this and ordinary utility rate cases." It is clear, transparently so, that a statute which requires the ascertainment of reproduction cost new less depreciation of a utility's physical property other than land to be used as the basis of valuation does not contemplate "junk value."

The argument about "junk value" advanced by counsel for appellee as a reason why going concern value need not be allowed was definitely set at rest by this court in *Denver* v. *Denver Union Water Co.*, 246 U. S. 178. In that case it was claimed before the master that the company had no franchise or legal right to continue in business and its

property should therefore be valued at its "junk" or salvage value. The master disagreed with this contention and valued the property on the basis of reproduction cost new, less depreciation. He also made a separate and specific allowance for the company's going concern value. This Court held the company had the right to continue in business at least until the city took affirmative action to oust it, and said at pages 190-192:

"In this situation, there can be no question of the company's right to adequate compensation for the use of its property employed, and necessarily employed, in the public service; nor can it be doubted that the property must be valued as property in use. It involves a practical contradiction of terms to say that property useful and actually used in a public service is not to be estimated as having the value of property in use, but it is to be reckoned with on the basis of its 'junk value.'

* * * * * * * *

"What we have said established the propriety of estimating complainant's property on the basis of present market values as to land, and reproduction cost, less depreciation, as to structures. That this method was fairly applied by the special master hardly is disputed by appellants, except as they contest the items allowed for 'going concern value' and for the water rights acquired by complainant and its predecessors by original appropriation. With respect to the former item, we adhere to what was said in *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 253, 165: 'That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned although dedicated to public use.'"

Although counsel argue this subject matter at considerable length and attempt to leave the impression that appellant's going concern value was provided for in the valuation, appellee disposed of it with the clear cut statement: "Going concern value will be disallowed" (R. 168.). It did not evade the issue or enter upon any such attempted defense of its action as counsel have in their brief.

Undistributed Construction Expenditures

(Appellant's Brief, pages 15 and 49-50; Appellee's Brief, pages 14-15, 47-49)

On page 14 counsel asserts "it was not error on the part of appellee and the court below to reduce the claim of appellant for this item from 17% to 14%" and again fall back upon their *omnium-gatherum* claim that the testimony was "purely speculative and conjectural"; and, although observing that reference to the result reached in other cases "under different circumstances is of litfle value in determining what is a proper allowance in this case," cite several prior decisions of appellee and the court below in which a uniform allowance of 7% for general overhead was made. They did not, however, cite appellee's decision in *Re Ohio Bell Telephone Company*, P. U. R. 1931 B, 46, 55, in which it allowed 17¼% for undistributed construction costs.

On page 49, counsel say: "It should be remembered that the allowance for this item is purely a judgment allowance, and we are of the opinion that the appellee was entirely justified in making an allowance of 14 per cent., and that such an allowance is more than ample." Counsel give no reason for this assertion or conclusion. We are willing to concede that the amount in any particular case is a judgment figure, but insist that the judgment must be that of a witness whose experience, training and special study of the

problem qualify him to make a proper estimate upon the matter. It is not the province of appellee to form its own conclusion on this subject matter without regard to the evidence. The question arises here only because of the fact that appellee and the court below arbitrarily fixed an amount for this item without reference to the record.

On page 49 counsel speak of the "unreliability of reproduction cost estimate of overhead." The laws of Ohio require the use of reproduction cost, and its consideration has also been required by this Court (*St. Louis and O'Fallon R. R.* v. *United States,* 279 U. S. 461). There would appear to be no more difficulty in estimating the cost of overheads than other construction costs.

Parenthetically it may be noted that the chief trouble with appellee's brief is that conclusions are drawn and authorities cited in support thereof based on mere assertions and assumptions without any reference to the facts of this case. While this practice occurs throughout the brief, we perhaps need only cite as illustrative the treatment of the item of undistributed construction expenditures.

Working Capital

(Appellant's Brief, pages 15-16, 51-52; Appellee's Brief, pages 15, 50-51)

On page 15 of their brief counsel say: "Upon the basis of the evidence in this case and in the light of all the circumstances, the amount allowed by appellee and affirmed by the court below was ample." As shown in our main brief the amount allowed was not based upon the evidence in this case and no circumstances were referred to or reasons given for disregarding it and arbitrarily fixing an amount substantially less than shown by the evidence to be necessary and proper.

At page 51 counsel say: "There is no dispute between appellant and appellee that some amount should be allowed for working capital. The only point of difference is the amount that should be allowed for this item." As the amount allowed by appellee is not based upon or supported by any evidence in the record, it is submitted that the real point of difference and question for consideration is whether the evidence is to be followed or wholly disregarded and an arbitrary amount fixed. Counsel concluded their discussion on page 51 with the customary refrain, that the evidence is "largely conjectural."

Annual Depreciation Allowance

(Appellant's Brief, pages 16, 54-55; Appellee's Brief, pages 16, 55-57)

At page 56 of appellee's brief it is said that the allowance of 2 per cent made by the appellee for annual depreciation is taken from the appellant's annual reports filed with the appellee. *These reports were not put in evidence, no reference was made to them by the appellee in its opinion or in its order denying appellant's petition for rehearing and its protest of valuation, and no reference was made to them in any way in the court below.* This is the first intimation appellant has had that these annual reports were used for any such purpose. If these reports were to be used for that purpose, appellant was entitled to notice of that fact at some time before final decision. The record contains nothing to show that this figure, 2 per cent, was taken from appellant's annual reports and the statement of counsel for appellee cannot supply evidence.

In *West Ohio Gas Co.* v. *Public Utilities Commission of Ohio*, 42 F. (2d) 899, 900, the Statutory Court said:

> "The Commission, examining its own records, found that the rate of 55 cents per thousand cubic feet, con-

tracted by plaintiff to be paid for natural gas at wholesale, was unreasonable and excessive in comparison with wholesale rates obtained by other gas companies in various cities and villages of Ohio by contract with wholesale distributors of natural gas. * * * The use by the commission of its files of schedules of other companies within the state as evidence supporting its present action was not brought about in the formal way by the introduction of the same in evidence at the time of the hearing of protests, but simply by taking notice thereof as a matter of public record, with no opportunity to the plaintiff either to be heard respecting them, or to introduce testimony respecting their nonapplicability to the situation confronting the plaintiff in securing gas for its service in the village. The schedules so referred to by the commission are not brought into this record, nor could they under the circumstances of the hearing, be brought to our attention; for it is established that the commission might not base its conclusions upon its files and other general information, unless the same were put in evidence in the particular proceeding, and opportunity given to the plaintiff to meet and explain them. The question is fully considered by a three judge court in this circuit, in *Illinois Central Railroad Co.* v. *Railroad Commission of Kentucky et al.*, 1 F. (2d) 805, 806, citing decisions of the Supreme Court of the United States on that subject, and we are constrained to follow its conclusions."

In the recent case of *Re City of Yuma*, 2 P. U. R. (N. S.) 8, an allowance of 4 per cent of the Arizona Edison Company's depreciable gas property was made for annual depreciation.

Reasonableness of Contract Price of Gas Purchased

(Appellant's Brief, pages 16-18, 55-61; Appellee's Brief, pages 17, 58-62)

The appellee in its brief lays great stress on the decisions in *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133, *Western Distributing Company* v. *Public Service Commission of Kansas*, 285 U. S. 119, and *State Corporation Commission* v. *Wichita Gas Company*, 290 U. S. —, and treats them as being conclusive of the question here under consideration.

We do not think this Court held, or meant to hold, in those cases, or any of them, that a relatively small natural gas utility, having a property valuation of only about $1,200,000, which happens to be affiliated with large producing companies and purchases gas from one of them, must try a rate case which would necessarily cost several hundred thousand dollars in order to justify the contract price in every instance in which some little town or towns with a relatively small number of consumers, sees fit to complain against its rates. If that is the only way that the contract price can be shown to be fair and reasonable, it imposes a burden on small utilities they cannot bear. There is, we submit, no justification for such an interpretation of this Court's decisions. There must be, and are, ways for such a utility to justify the price it pays for gas without incurring expense which, if included in the company's operating expenses, would increase the rates to consumers more than would be saved by a reduction in the contract price, and if not included in the company's operating expenses would deprive its stockholders of all the return to which they are entitled for rendering the service.

Appellee claims to have allowed the appellant a return amounting to $56,445 a year. It would take all of this re-

turn for several years at least to pay the expense of a rate case involving the valuation of the property of the Ohio Fuel Gas Company, in the State of Ohio, amounting, according to the appellee's own inadequate valuation to $74,000,000, and also the property of the United Fuel Gas Company, in West Virginia and Kentucky, amounting, according to the appellee's inadequate valuation, to $37,000,000, together with the business and operations of these companies in the public service and outside it.

Valuation of No. 1 Leaseholds.

(Appellant's Brief, pages 18-19, 79-108; Appellee's Brief, pages 18-20, 66-124)

A Significant Admission

The appellee's brief on this question adopts the argument of the city of Columbus in the Columbus case and quotes almost all of it verbatim, at pages 66-124. However, it is significant that on page 106 there is an omission indicated by stars. The omission consists in parts of pages 164-165 of the city's brief in the Columbus case. The last paragraph omitted reads as follows:

> "The $25.00 per acre fixed as the value of the Logan property, as of December 31, 1924, was practically an arbitrary valuation, although a little color for the use of the figure was found in the record from the testimony of certain witnesses that is was the amount used per acre for certain of the leaseholds in question by certain of these companies dealing between themselves. There is nothing of that nature in the record in this case."

The foregoing is a very significant statement. It admits that the value of $25.00 per acre fixed in the Logan case was arbitrary. The Logan case above mentioned is the latter of the two Logan cases cited and quoted from so often in

appellee's brief and is reported in 124 O. S. 248. The special counsel for the city of Columbus in *Columbus Gas & Fuel Company* v. *Public Utilities Commission* now pending before this Court who wrote the above paragraph, was a member of the Public Utilities Commission of Ohio at the time of the decision by the appellee of the Logan case therein mentioned. Undoubtedly he knows what he is talking about when he says that "the $25.00 per acre fixed as the value of the Logan property * * * was practically an arbitrary valuation."

The valuation of leaseholds in the above-mentioned Logan case, although admittedly arbitrary, was no more so than the determination by appellee and the court below of the amount of leaseholds used and useful in the earlier Logan Gas Company case (121 O. S. 507), which determination is cited and followed by the appellee and lower court in this case. We respectfully submit that the above quoted admission deprives the Logan cases of any weight whatever as precedents.

Values of Leaseholds Proved Are Not "Astounding" or "Imaginary"

At page 77 of appellee's brief, the values of leaseholds proved by the company are referred to as "astounding values"; and at page 79 they are called "imaginary values." If the values proved were "astounding" or "imaginary," why did not the city or appellee prove that fact? Clearly, if the values proved in a case of such prominence were "astounding" or "imaginary," it would not be difficult to find competent witnesses who were able and willing to testify to that fact. The city made no attempt to introduce such testimony. Having failed to present testimony on the subject they cannot supply it by the use of rhetorical language.

United Fuel Gas Company v. *Public Service Commission of West Virginia*, 14 *F.* (2*d*) 209, *Distinguished.*

At pages 86-87 of appellee's brief, the above mentioned case is cited and quoted from at length as an authority for valuing only the operated leaseholds. In that case, the court below allowed, and this Court affirmed, a valuation of $10,317,311.39 for the "gas reserve presently used and useful in the public service ('proven' territory)." There were 136,384 acres of "proven territory" included in that valuation (287 *U. S.* 322, *at* 325). *This means the court below allowed, and this Court affirmed, a valuation of* $75.65 *an acre for the operated leases of the company, whereas, in this case the "book value" of No.* 1 *leaseholds which the lower court holds must be used in lieu of the present value thereof amounts to* $5.38 *per acre* (see our principal brief, page 104). Moreover, in that case the delay rentals, or carrying charges, on all the unoperated leases were allowed as a part of the company's operating expenses; in the instant case, all such delay rentals are excluded from the operating expenses. In reviewing the decision of the Statutory Court in the above cited case, this Court said:

> "The court below made no finding as to the value of appellant's gas rights. It included in the rate base the 136,384 acres of land described by appellant's witnesses as proven territory, that is, areas which had been thoroughly tested and are now producing gas, and excluded 126,208 acres of land described as probable territory, that is, territory which had been partially tested or which appeared on the basis of geological evidence and its geographical relation to productive areas to be a probable source of natural gas. It was by this division of appellant's gas field and the inclusion of but a part in the rate base, at the full value claimed by appellant, that the court below reached its assumed valuation of the gas field of $10,317,311. The rest of the territory, consisting of 552,319 acres classified as

improbable or unfavorable territory, was disregarded *by the court below and appellant's own experts in estimating available gas supply.*" (278 U. S. at 290)

Immediately following the matter quoted from his opinion, Judge Rose said:

> "If we are right, $10,317,311.39 is the highest valuation which can be put upon such portion of plaintiff's reserves as it has any claim to include in its rate base." (14 F. (2d) 222, first column)

Again, at page 217, referring to an opinion of the West Virginia Commission, Judge Rose said:

> "As the plaintiff's evidence relating to the increase in value dealt solely with 'gas reserves' and 'gas acreage,' it was in his view beside the mark. No testimony *had been offered as to the worth of the contracts as such* and subject to their varying terms, conditions, and limitations." (14 F. (2d) 217)

The book value of *all* the company's gas rights and leaseholds was $6,343,329.67 (278 U. S. page 284).

As the question here involved is primarily one of confiscation of property, the substance of the decision, and not merely the theory or the terminology, is the vital thing. It will be observed that the court allowed for the [illegible] acres of operated leaseholds 62 per cent more than the total value of all the leaseholds amounting to [illegible] acres.

Appellee's Theory That Public Service Is Increased and Which Lessens Value of Leaseholds

At page 95 of appellee's brief, it is said:

> "There exists a very important encumbrance upon these leaseholds arising out of the public utility obligation resting upon them, but the witnesses in placing a so-called market value upon them, gave it no consideration."

That the theory is unsound is clear under the decisions of this Court. The *Minnesota Rate Cases* (*230 U. S. 352*) definitely settled the rule that the general market value of real estate is the value at which it must go into the rate base, and that nothing can be added to that value because of the use of the property in the public service, and this rule has not been questioned since that decision. Inasmuch as nothing can be added to the value of such property because of its use in the public service, it necessarily follows as a matter of simple justice that nothing can be subtracted from that value because of the use of the property in the public service. This view is entirely consistent, and is the only view that is consistent, with the decisions of this Court as to what constitutes compensation for use of a utility's property in the public service—that is, that it is entitled to earn a reasonable return upon the present fair value of that property, in order to prevent confiscation, and that in all such cases involving compensation for property under the constitution, the general market value of the property is the final test of compensation. Nowhere in the decisions of this Court is there any justification for the theory that a deduction can be made from the value of the property of a public utility because it is used in the public service, in fixing the amount of return to which the utility is entitled.

If the appellee's theory were the law, it would be impossible to value property of a public utility, because it would be impossible for any witness to say how much should be deducted from its value because of its use in the public service, and the matter would necessarily be left to the arbitrary determination of the commission. It would furnish a means of evading the decisions of this Court which sustain the right of a utility to earn a reasonable return upon the present fair value of its property used and useful in the public service.

That the appellee actually believes that it has the right to so fix values seems clear from the fact that in its opinion in the Columbus case (R. 150, fol. 223), it said:

> "* * * the value of the land in the market would depend upon the price which the regulated company *may be permitted (sic!)* to charge to its customers." (Italics supplied.)

Further illustrations of the same thought appear at different places in the record, one good illustration being at R. 1284 (Columbus Record), where one of the commissioners said to the witness Webber:

> "Q. * * * you estimate the value of the acreage by having some general knowledge of how much you could sell that gas for; *we have got to say how much you sell that gas for and turn around and find out how much his property is worth producing gas.*"

The doctrine here under the consideration is not a minor matter. It goes to the very vitals of utility rate making. If it is correct, all the decisions of this Court which prescribe the limits below which utility rates cannot go without confiscation would be ineffective.

Appellee Contends Market Value of Leaseholds, if Established, Could not Be Adopted "for Rate Purposes"

Again, substantially the same thought reappears at pages 99-100 of appellee's brief, where it is said:

> "We submit that there is no market and that the bases assumed by these company witnesses were wholly speculative and uncertain, *but that, even though there were a market, the value of the lands for rate purposes could not be established by what they would bring in exchange.*"

Here we have a clear-cut issue—*a bald statement of the appellee's position that the market value of the leaseholds, even when established by the evidence, cannot be accepted and included in the rate base.* This is the old, exploded doctrine that the term "*value*", in a rate case, means something different from what it means in other cases involving compensation for property. No decision of this Court justifies that distinction. If commissions and state courts could attach to the term "value" a meaning of their own differing from that given to it by this Court they could evade the decisions of this Court which guarantee to utilities a return upon the present fair value of their property used and useful in the public service as a minimum below which state made rates cannot go without confiscation. (No question of the value of service is involved in this case) In *Erie* v. *Public Service Commission* (*Pennsylvania Gas Company* v. *Public Service Commission*), 278 Pa. St. 512, the Supreme Court of Pennsylvania reversed the Public Service Commission and Superior Court of that state for rejecting the general market value of gas producing lands which was established by testimony similar to that in the instant case. In delivering the opinion of the Court, Mr. Justice Kephart accurately stated the applicable law on the point as follows:

> "While the busines of supplying gas is national in character, affected with great public interest, and the commodity a product of nature, such circumstances do not differentiate these holdings from any other class of property in private ownership. There should not be one rule for valuing property generally for rate making, another for gas lands used in public service, another for condemnation, another for taxation, and still another for private sale or exchange. If the property which legally enters into the consideration of the question of rates has increased in value since it was

acquired, the company is entitled to the benefit of such increase: *Willcox* v. *Consolidated Gas Co., supra,* 52; *Georgia Ry. Co.* v. *R. R.Comm., supra,* 631; *Bluefield Co.* v. *P. S. C. of West Virgina, supra,* 690." (Pages 524-525)

* * * * * * *

"The standard to be applied in fixing present value of lands would be 'present market value'; *Denver* v. *Denver Union Water Co., supra,* 191; *Willcox* v. *Consolidated Gas Co., supra.* In so considering it (Minnesota Rate Cases, *supra,* a greater value cannot attach because used in public service. The rule is limited to general market value outside the public service, or in a market not considering such service. While this may call for careful scrutiny of the evidence, such considerations afford no excuse for refusing to give the value required by law. The rule was applied in valuing Neville Island: *Ben Avon Boro.* v. *Ohio Valley Water Co.,* 271 Pa. 346. The test, under the Fourteenth Amendment, in rate cases, is whether the utility is deprived of its property or a part of its value in the return allowed. The rule of just compensation, as in condemnation cases, should be applied to gas lands (*Smyth* v. *Ames, supra,* 546; *Reagan* v. *Farmers' Loan & Trust Co.,* 154 U. S. 362, 410; *Minnesota Rate Cases, supra; Mercerburg, etc., Electric Co.* v. *P. S. C.,* 76 Pa. Superior Ct. 58, 65), though generally the rate base may include elements not properly cognizable in condemnation cases. Property is protected by protecting its value, which, in this class, is what it is worth in a fair market. In fixing market value for a present value, we bring the holdings under the constitutional protection governing condemnation for public or quasi public uses." (Pages 525-526)

* * * * * * *

"The company produced witnesses who testified the market value of the sixteen selected warrants was from $7,212,000 to $10,000,000, and the Ludlow field $4,-

000,000. It appears these gas fields were developed, defined and have been in actual operation producing gas from a known sand for a great many years, sufficient to show the quality. It is no longer doubtful among those familiar with the business, whether expert geologists or engineers or practical gas-producing men, that the remaining life of the fields can be determined with reasonable accuracy—with as much accuracy as is used in dealing with ordinary affairs of life. While this may be said to be a matter of conjecture, because not seen, as is a seam of coal, and it may suddenly end, the frequency of this in a defined territory is remarkably small. It is on such examinations large sums of money are invested. Most of the witnesses base their estimates on their knowledge of the field in general. The location of the lands was shown, location of the wells, the date each well was drilled, its depth, the character of sand in which gas was found, its thickness, the initial open flow volume of gas, the initial present rock pressure, the line pressure, the volume of gas delivered January, 1920, by each well into the line against the line pressure, together with the details of measurement on which the computation of the present volume is based. . . . The commission, in valuing the gas holdings, stated, 'Taking into consideration the total gas holdings of the respondent, with all the testimony bearing on their present value, we are of the opinion that the used and useful portions attributable to Pennsylvania should be included in the rate base at $5,500,000.' The lowest value under the evidence was $11,212,000; it is apparent, from what the commission said, they proceeded on an erroneous conception of the evidence. Much, if not all, of the testimony would have been admitted as evidence of market value in condemnation of the same land. No attack was made on the competency, sufficiency or credibility of the witnesses to establish the fact of general market value." (Page 526-527)

Blundon's Figures of Alleged Cost of No. 1 Leaseholds

At pages 104-105 of appellee's brief, the statement is made that City Exhibit 115 in the Columbus case shows that the average price paid by the Ohio company for leaseholds of Class No. 1, in 1927, 1928 and 1929 was from 62¢ to $2.05 an acre. The testimony of the witness referred to and the exhibit mentioned are very misleading. Except a few renewals, the leaseholds referred to by the witness as "No. 1" and for which he says the Ohio company paid an average price in 1927, 1928 and 1929 of $2.05 per acre, were not No. 1 leaseholds at the time they were acquired—that is, there were no producing gas wells on them at that time. They were merely leases of land which were undeveloped at the time they were obtained, but which proved to be good gas producing territory when they were subsequently drilled. For instance, the first lease listed in said City Exhibit No. 115 (R. 3187) is the M. Wittemire lease, file No. 84,073, in Green Township, Ashland County, containing 30 acres. A reference to Company Exhibit No. 145, page 5, shows that this lease was acquired March 28, 1927, and that the well thereon was drilled May 17, 1929, more than two years later. Of course, at the time this lease was acquired on March 28, 1927, it was not an operated, or Class No. 1 lease. There is no justification for saying that the prices paid for such leases were prices paid for Class No. 1, or operated, leaseholds, and for the witness and the appellee's counsel to so treat them is very inaccurate, to say the least.

Moreover, an examination of page 2 of Company Exhibit No. 142 shows a map of Green Township, Ashland County. In section 20, which is a little west and slightly south of the center of the township, appears this lease No. 84,073, containing 30 acres, but it appears in the name of Tobias Wittemire; that it is the same lease is established by the

number. At the time that lease was acquired by the Ohio company the John K. Cowen lease, which is east, northeast and southeast of it, had not been drilled. This appears by the same page of Company Exhibit No. 145, which shows the date of the drilling of the two wells on the Cowen lease to be subsequent to the acquisition of the Wittemire lease. In other words, there was no producing gas well close to the Wittemire lease at the time it was acquired, and, of course, the consideration paid was for an undeveloped lease; that it happened, subsequently, to prove to be good gas producing territory does not affect the fact that it was an undeveloped lease when acquired. The well drilled on this Wittemire lease produced, when drilled in, 1,292,000 cubic feet of gas a day and had an initial rock pressure of 1180 pounds (Company Exhibit 145, page 5). It is absurd to say that a land owner, if it had been proved that the land would produce wells of that size, would lease it at $2.05 an acre, or $61.50 for the lease. This is a sample of the unfairness of calling these leases No. 1 leases, contrary to the plain fact.

Amortization

(Appellant's Brief, pages 20, 109-117; Appellee's Brief, pages 109-124)

At page 118 of appellee's brief, the testimony of Professor Dewing is quoted to the effect that because of "the possibility of the use of producer gas in connection with natural gas, and the ultimate substitution of producer gas for natural gas, if necessary," he did not agree that "it would be the part of good business to put aside a reserve of four per cent each year to get the capital back at the end of 25 years," etc. Disregarding the fact that the witness had not been introduced or examined by the company on

any such subject, the following considerations regarding the testimony quoted should be noted:

1. The assumption that producer gas will be used instead of natural gas is purely speculative. If the company had introduced and relied on testimony so hypothetical and uncertain, no credence would be given to it. The same rule should be applied in its favor that would be applied against it.

2. The court below did not base its holding that the laws of Ohio make no provision for amortization on any *evidence* in the case, but on its *interpretation of the statutes.*

3. The testimony quoted takes no notice whatever of the undeniable depletion of leaseholds and the consumption of the properties known as gas well construction and gas well equipment in the public service or of the further fact that all field lines, large transmission lines, compressor stations, etc., would become useless with the exhaustion of natural gas. We do not note anywhere in appellee's brief a denial that, as a fact, these particular properties are used up in the public service.

The court below did not accept this testimony, or any other testimony in the case to the effect, as alleged by appellee, that there was no probability of exhaustion of the gas supply; but, to the contrary, the court said: "That the product natural gas will eventually die is self evident." (R. 74)

The general corporation laws of Ohio, recognize depletion. *Ohio General Code, section* 8623-38, contains the following:

> "(a) A corporation may declare dividends payable in cash, shares, or other property out of the excess of the aggregate of its assets less the deductions hereinafter required over the aggregate of its liabilities plus stated capital.

(b) In computing the excess of the assets, deductions shall be made for *depletion*, depreciation, losses, and bad debts." (Italics supplied)

Rate of Return

Counsel for appellee open their argument on this subject with the statement (p. 21): "The contention of the appellant that it is entitled to a minimum rate of return of 8% for the period from July 17, 1921 down to the present time is entirely unwarranted." If the rates to which appellant was remitted by appellee were confiscatory on the date certain, its order in this case and the judgment of the lower court must be set aside.

On page 22 counsel remark that "the contention of the appellant that it is entitled to an unusually high rate of return on the basis of the hazardous nature of the gas business is based upon a theory which has long since been exploded." From its further reference to this "theory" on page 133 it is presumed that counsel for appellee referred to the danger of exhaustion of the supply of natural gas for the towns in question. No reference is made to any testimony or evidence on this subject matter. The fact that a mining venture like the production of natural gas is fraught with much greater hazard than most other utility service is known to all who are familiar with the matter.

On page 133 counsel say: "It should be further borne in mind that appellant is not entirely a gas company." While it is true appellant furnishes electric current to a number of communities, it does not furnish this service to all of the towns involved in this proceeding. Only appellant's natural gas business is involved in this case.

Counsel for appellant make reference to the business depression (pages 129-130) at the time "this matter (was) before the appellee (1930-1932)" and assert that appellant's argument would have appellee ignore its "actual ex-

perience'' under the increased rates since July 17, 1929. As already noted appellee blows hot on rate of return and cold on taxes. If appellant's revenues (''actual experience'') be considered for these depression years rather than for the years 1928 and 1929 contained in the record (R. 581) the appellee could not have found it ''to have been slightly in excess of 6½%'' (Appellee's Brief, p. 129).

If judicial notice is to be taken of the effect of the business depression on appellant, the fact that its cost of rendering gas service is a more or less *fixed* amount (regardless of temporary business conditions), that the depreciation of its property continues just the same, and that its taxes have been substantially increased since the business depression set in, should be considered.

The following allowances for return have been made in recent natural gas cases (during the period referred to by counsel for appellee):

	Per cent
Bowdoin Utilities Co. (Mont.), P. U. R. 1931 B, 20 (8% additional allowed for depreciation and amortization)	8
Oklahoma Natural Gas Corp. (Okla.), P. U. R. 1931 B, 470 (5% for depreciation and amortization)	8
Rushville Natural Gas Co., (Ind.), P. U. R. 1931 D, 92 (6¾% for depreciation and amortization)	7
Western Ohio Public Service Co. (Ohio), P. U. R. 1931 D, 1	7

Conclusion

Attention is again invited to the fact that the questions presented in this case have to do with the application of fundamental legal principles to established facts. Items of property value and operating expense proved by uncon-

tradicted and credible testimony were disallowed in whole or in part. The disposition of these issues so vital to the natural gas industry will determine its ability to continue rendering a useful public service in the State of Ohio. The decision of the court below being without evidential support and contrary to the law of the land should be reversed.

Respectfully submitted,

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Dayton, Ohio, March 12, 1934.